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STATE FOR WHA/MEX, WHA/EPSC, EB/IFD/OMA
STATE FOR EB/ESC MCMANUS AND IZZO
USDOC FOR 4320/ITA/MAC/WH/ONAFTA/GWORD
USDOC FOR ITS/TD/ENERGY DIVISION
TREASURY FOR IA (ALICE FAIBISHENKO)
DOE FOR INTL AFFAIRS KDEUTSCH, ALOCKWOOD, AND GWARD

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SUBJECT: MEXICAN FINANCE UNDERSECRETARY OPTIMITIC ON ENERGY
REFORM

Introduction and Summary

¶1. (SBU) In an August 21 meeting with Congressman Roy Blunt (R-Missouri) Mexican Finance Undersecretary Alejandro Werner (strictly protect throughout) predicted that if fiscal reform goes well, the Calderon Administration would next turn to reform in the energy sector. He explained that Pemex needs to retain more revenue in order to make the investments needed to reverse the current decline in oil production, and described the need to overhaul Pemex's corporate governance. In order to develop new technology and get technology transfer needed to explore new deep water fields, Pemex must be allowed some form of association with other companies. Nevertheless, despite his substantial authority as a senior member of the Administration, Werner's optimism does not jive with our other energy sector sources. End Introduction and Summary.

Mexico Needs Private Sector Involvement

¶2. (SBU) Werner explained that of all the countries in the world, Mexico was the most closed to foreign investment in the energy sector. Even Cuba allows Spanish refineries. Mexico imports growing volumes of gasoline from the U.S. rather than allow private investment in refineries. Werner noted that Pemex shares ownership with foreign firms -- specifically Shell -- for its U.S.-based operations, but not for operations based in Mexico. Werner noted that many state-owned energy companies in other countries allowed public-private partnerships, in order to modernize their operations. He said that currently Pemex accounts for about 8 percent of GDP, five percent of which goes directly to the government, and only three percent of which is left for Pemex. He said that in order to develop new technology and get technology transfer to explore new deep water fields, Pemex must be allowed some form of association with other companies.

Better Business Practices

¶3. (SBU) Werner described the need to overhaul Pemex's financial and management structure, perhaps floating capital in stock markets and allowing significant representation of Pemex's board for minority shareholders. Pemex also needs

corporate accounting practices so that Pemex would be governed by market rather than government controls. He added that Pemex should look at market incentives like the Brazilian and Norwegian state oil companies. The goal would be to provide market oversight of Pemex.

Reform in 2008

¶4. (SBU) Werner predicted that if the Calderon Administration succeeds in its current attempt to get the Congress to pass fiscal reform, the government should have a signficant package on energy reform approved by the middle of ¶2008. He said Mexico was stuck in an ideological discussion on whether to "privatize" Pemex. The Mexican Government would not privatize Pemex; rather, it needed to undertake a "process of reforms." The Administration and Congress were not holding "all or nothing" discussions. Werner said the current discussions with the PRI on energy reform were "driven by the PRI," rather than by "taboos" over whether to allow private sector participation that have long blocked reasoned debate. During Congressional debate on fiscal reform, the PRI had called on the government to address Pemex's declining revenues, which in turn Werner said was leading to discussion on improving Pemex's corporate governance. Werner said this discussion would also include consideration of allowing Pemex to make some form some of association with private companies. Between energy and fiscal reform, Werner said he thought the PRI was ready to support a program that would give the government 80% of what was needed to fix the challenge Mexico faces from low tax revenues and declining oilproduciton. Werner chose his words carefully, stressing that there was no discussion of privatization. Nor did he specifically mention foreign

investment. He noted that in considering energy reform, all sides were haunted by the narrow election results in July 2006, so that nobody wanted to give the PRD issues it could use to raise "nationalistic fervor."

¶5. (SBU) Werner was optimistic the Congress would support reform of the energy sector, because Congress already supported reform on the financial sector to address the problem of overly conservative rules for lending by banks to small and medium enterprises (SME's) that result in rules impossible for SME's to comply with. (Werner noted the need to work to push lending to SME's over the next few years. He said that in Mexico private sector lending was 16% of GDP, while in Chile it was 60 to 70 %.)

Comment

¶6. (SBU) Werner's optimistic outlook on the future of energy reform mirrors what we heard from the Calderon team early in the term: (1) energy reform was synonymous with making Pemex more efficient; (2) no Mexican party wants to "privatize" Pemex, but rather the word "privatization" was only a word used by the PRD to over politicize the debate, and; (3) the market could do a better job of overseeing Pemex than government regulators. Nine months into the Administration the picture has become more obscure, and few observers, besides Werner, now share the Undersecretary's optimism. Energy Secretariat officials who had previously described aggressive plans to win over Congress are silent. Outside observers who had been enthusiastic about the chances for reform under Calderon have become much more cautious, and relatively minor changes in distribution of Pemex tax revenue are now being touted as energy reform by the PRD and the PRI. End Comment.

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